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In the Supreme Court of the United States

OCTOBER TERM, 1969

FLORENCE M. BARNES, and BARNES THEATRE TICKET SERVICE, INC., an Illinois corporation,

Petitioners,

vs.

THE COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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THE COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Florence M. Barnes and Barnes Theatre Ticket Service, Inc., an Illinois corporation, petitioners herein, pray that a writ of certiorari be issued to review the decision of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS OF THE COURTS BELOW

The Memorandum Findings of Fact and Opinion of the Tax Court of the United States and Decision entered pursuant thereto reported at 26 TCM 1290, are reproduced

as Appendix I to this Petition. The decision of the United States Court of Appeals for the Seventh Circuit reported at 408 F2d 65 is reproduced as Appendix II to this Petition and the order of said court denying a rehearing en banc is set forth as Appendix III.

JURISDICTION

The decision of the United States Court of Appeals was rendered March 5, 1969. The Petition For A Rehearing En Banc was denied April 10, 1969. The United States Court of Appeals issued its Mandate to the Tax Court of the United States on April 23, 1969. Pursuant to motion of Petitioners for a Stay of Mandate, treated by the Court of Appeals as a Motion For Recall and Stay of Mandate, said Mandate was recalled and stayed for a period of 30 days on May 12, 1969. The order entered pursuant to this motion is attached hereto as Appendix IV. Petitioners filed a subsequent Motion For Stay of Mandate and the Court of Appeals ordered said Mandate stayed until July 9, 1969. This order is attached hereto as Appendix V.

The jurisdiction of the Supreme Court of the United States is invoked under Title 28 United States Code, Section 1254.

QUESTIONS PRESENTED

1. Where the Commissioner of Internal Revenue determines that a portion of taxpayer's cost of goods sold are to be disallowed, does due process require disclosure by the Commissioner as to which transactions are challenged?

2. Whether the decision of the United States Court of Appeals for the Seventh Circuit is in conflict with the decision rendered by this Court in *Helvering* v. *Taylor*, 293 US 507 (1935)?

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Due Process clause of the Fifth Amendment to the Constitution of the United States, Title 26 United States Code Section 6212(a) Title 26 United States Code, Section 7453; Tax Court Rules of Practice Rule 32, reproduced as Appendix VI hereto.

STATEMENT OF THE CASE

On December 27, 1963 the Petitioners received a notice of deficiency (Appendix VII) which set forth a total deficiency in income taxes of $88,663.60 for the years 1955 through 1958. This deficiency was allegedly due to an overstatement of costs of operations as follows:

Year	Claimed	Allowed	Overstatement Cost of Operations
1955	$569,785.75	$499,010.61	$70,775.14
1956	499,164.30	436,451.28	62,713.02
1957	391,912.95	370,077.06	21,835.89
1958	475,372.89	460,929.65	14,443.24

The notice of deficiency did not specify which cost figures were challenged. The Petitioners sought to contest this determination in the Tax Court and to this end introduced their entire bookkeeping system into evidence as well as the testimony of their bookkeeper. The Commissioner did not at or during trial give further particulars as to disallowed costs. The Commissioner did not introduce at or during trial evidence in support of his determinations.

The United States Court of Appeals for the Seventh Circuit affirmed, J. Swygert dissenting, and denied a Petition for Rehearing En Banc.

Jurisdiction of the Tax Court is based on Title 26 United States Code Sections 7442 and 6213 (a) reproduced as Appendix VIII hereto.

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT

I.

THE PETITIONERS WERE DEPRIVED OF DUE PROCESS OF LAW IN VIOLATION OF THE FIFTH AMENDMENT TO THE CONSTITUTION OF THE UNITED STATES.

A.

The Application Of The Presumption Of Correctness To The Notice Of Deficiency Deprived The Petitioners Of Procedural Due Process Of Law.

The Court of Appeals in this case held that a notice of deficiency need only advise a taxpayer that the Commissioner means to assess him. Once this is done, a presumption of correctness is raised in favor of this determination and the burden of proof is placed on the taxpayer. (App. 27). The Commissioner need only disclose the amount of the deficiency—he is not required to disclose its basis, method of computation or even what items specifically are being challenged.

This decision has declared open season on all taxpayers. As J. Swygert indicated in his dissent, (App. 35), there is nothing to prevent the Commissioner from pulling a figure out of the reaches of his imagination and proceeding to enforce it if the taxpayer's books are not sufficient to disprove every possible theory of taxation. (App. 31). The Petitioners submit that they have a right to know wherein they have allegedly failed. The failure of the notice of deficiency so to inform the taxpayers in this case required them to grope in the fog through a Tax Court

trial in the hope that they might grasp something identifiable. To hold that the notice of deficiency in such a case is presumed correct and that the taxpayer has the burden of proof can only result in a deprivation of due process in violation of the Fifth Amendment to the Constitution of the United States.

Although due process is not capable of reduction to a simple formula or precise definition, it is susceptible to empirical definition within the framework of decisional law. "Fairness" and "fair play" may be said to be the touchstone of procedural due process; *Joint Anti-Fascist Refugee Comm.* v. *McGrath*, 341 U.S. 123, 161, (1950); *Kinsella* v. *United States*, 361 U.S. 234, (1960). Protection of the individual from arbitrary action is the essence of due process, *Slochower* v. *Board of Higher Education of New York City*, 350 U.S. 551 (1955).

Individuals are entitled to a fair hearing on the fundamental facts before their property is taken under the edict of an administrative officer, *McGrath, supra*, p. 162.

In *Green* v. *McElroy*, 360 U.S. 474, (1959) this Court stated:

> "It is an immutable principle of jurisprudence that where governmental action seriously injures an individual, and the reasonableness of the action depends on fact findings, the evidence used to prove the government's case, documentary evidence and even more important testimony, must be disclosed to the individual so that he has an opportunity to show that it is untrue."

The well entrenched principles of due process as announced by this Court in decision after decision have been abandoned in the consideration of this case by the courts

below. They have instead clung to narrow procedural rules the application of which have denied the Petitioners herein of a fair hearing upon the fundamental facts.

B.

The Requirement That The Taxpayers Show That The Deficiencies Were Computed In An Improper Manner Or That Their Books And Records Accurately Reflected Their Income Deprived The Petitioners Of Procedural Due Process Of Law.

The Court of Appeals stated in its opinion that "The critical question arises, as stated by the Tax Court, whether taxpayers adduced sufficient evidence showing that the asserted deficiencies were computed in an improper manner or by showing that its books and records adequately and accurately reflected its income, or by producing a combination of such evidence." (App. 28).

The Petitioners could not show that the deficiencies were computed in an improper manner because disallowed cost items giving rise to the deficiencies were never disclosed and hence the manner was not known. The effect of the Court's position was to place upon the Petitioners the burden of introducing books and records which in their entirety could conclusively disprove the asserted deficiency. By the Court's own measure, the Petitioners were deprived of one of two elemental methods of proof, that is, the introduction of evidence showing that the deficiencies were improperly computed. The Petitioners contend that the application of this "critical question" to this case deprived Petitioners of due process of law under the Fifth Amendment to the Constitution of the United States.

II.

THE DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT IS CONTRARY TO THE DECISION OF THIS COURT IN HELVERING v. TAYLOR, 293 U.S. 507 (1935).

In *Barnes,* out of hundreds of substantially identical ticket purchases totaling almost two million dollars over a four-year period, the Commissioner has determined that a portion of each year's total purchases should be disallowed. The notice of deficiency issued by the Commissioner which set forth these disallowances failed to disclose the challenged transactions. The Commissioner failed to offer evidence in support of his position at trial. The Petitioners introduced their entire set of books at trial in an attempt to substantiate their cost of goods sold figures. The Court of Appeals affirmed the holding of the Tax Court that the notice of deficiency was sufficient to raise the presumption of correctness and to place the burden of proof on the taxpayers. Petitioners contend that the notice of deficiency in this case was arbitrary and without apparent rational foundation under the rule of *Helvering* v. *Taylor,* 293 U.S. 507 (1935). The holding of the United States Court of Appeals for the Seventh Circuit in this matter is contrary to the holding of that case.

In *Helvering,* the taxpayer purchased all the stock of four utilities at a total cost of $96,030. He then organized a holding company to which the utilities' stock was transferred in exchange for all the shares of the holding company, to wit: 1,000 shares of no par value preferred entitled to $100 on liquidation; 2500 shares of no par value class A common; 5000 shares of no par value class B common having the voting power.

The holding company subsequently sold the utilities' stock to another corporation for $194,930.16. Later in the

year, the holding company retired all of taxpayer's preferred stock paying him $99,000 therefore. In his 1928 return, the taxpayer ascribed the entire price paid for the utilities' company stock ($96,030) as the basis for the preferred holding company stock, and reported the difference of $2,970 as his gain on the sale.

The Commissioner took the position that the taxpayer was not entitled to charge the cost of all the stock to preferred and apportioned to preferred a cost based on the ratio of the amount the taxpayer received on retirement of preferred to the total received on the sale by the holding company multiplied by the taxpayer's original cost. Thus of the $96,030 paid for the utilities' stock, $48,771.16 was chargeable to the preferred. A gain of $50,228.84 was imputed to the taxpayer upon which the Commissioner determined a deficiency of $9,156.69.

The Board of Tax Appeals, without specific findings of fact made the same determination. The taxpayer failed to prove facts from which a correct determination could be made. The Court of Appeals held the determination excessive and since the evidence did not show the correct amount remanded the case for further proceedings.

The question presented on petition for Writ of Certiorari was:

> "Whether the Circuit Court of Appeals erred in remanding this case to the Board of Tax Appeals for a new hearing on the ground that the Commissioner's determination of the amount of income was incorrect, although the taxpayer had failed to prove facts from which a correct determination could be made."

Thus, as stated at p. 511 of the opinion, the appellate court rightly held the evidence sufficient to require a find-

ing that the Commissioner's apportionment, and hence determination, were unfair and erroneous, even though the taxpayer failed to establish the correct amount.

The Supreme Court rejected the Commissioner's contention that since the taxpayer failed to establish facts on which a fair apportionment could be made, the Commissioner's determinations should be sustained. The Court held at p. 514:

> "We find nothing in the statutes, the rules of the board or our decisions that gives any support to the idea that the commissioner's determination shown to be without rational foundation and excessive will be enforced unless the taxpayer proves he owes nothing or, if liable at all, shows the correct amount. While decisions of the lower courts may not be harmonious, our attention has not been called to any that persuasively supports the rule for which the commissioner here contends.
>
> "Unquestionably the burden of proof is on the taxpayer to show that the commissioner's determination is invalid. (citations omitted). Frequently, if not quite generally, evidence adequate to overthrow the commissioner's finding is also sufficient to show the correct amount, if any, that is due (citations omitted). But, where as in this case the taxpayer's evidence show the commissioner's determination to be arbitrary and excessive it may not reasonably be held that he is bound to pay a tax that confessedly he does not owe, unless his evidence was sufficient also to establish the correct amount that lawfully might be charged against him. On the facts shown by the taxpayer in this case, the board should have held the apportionment arbitrary and the commissioner's determination invalid.
>
> "Then, upon appropriate application that further hearing be had, it should have heard evidence to show whether a fair apportionment might be made and, if so, the correct amount of the tax."

The Petitioners herein similarly contend that the Commissioner's determinations are arbitrary on their face, without rational foundation and therefore could not be presumed correct. This contention is based on the failure of the Commissioner to disclose which purchases of tickets were disallowed. The Court of Appeals largely ignored this position and simply held: "We find no prejudice to taxpayers resulting from the form of the statutory notices." (App. 27).

The Petitioners contend that this holding is directly contrary to that of *Helvering* v. *Taylor, supra,* when this Court held that the Commissioner's determination is arbitrary when examined by itself and for what it is rather than to determine arbitrariness by an examination of the Petitioners' books to ascertain whether they give a foundation for a correct determination.

The Petitioners contend that the Commissioner's determinations were arbitrary. The question of the sufficiency of the taxpayers' books and records should not have been reached.

III.

THE QUESTIONS AND ISSUES PRESENTED ARE OF FUNDAMENTAL IMPORTANCE AND STAND IN GREAT NEED OF CLARIFICATION.

The broad question of what renders a Commissioners determination arbitrary has not been addressed by the Supreme Court since 1935, the date of the *Helvering* decision. The precise question of the degree of disclosure required in a Notice of Deficiency has never come before the Supreme Court and is in desperate need of clarification. Standards must be established in this area that are both consistent with due process and this Court's decision in *Helvering, supra.*

The various Circuit Courts of Appeal and courts of original jurisdiction, while generating much dicta, have contributed nothing significantly helpful. Cases in support of the proposition that no special form for a statutory notice of deficiency is required have been cited by the Commissioner. While some of these cases do contain language to that effect, an examination of the issues decided and the factual situations involved will disclose material factors which provide ample ground for distinguishing those cases from the one at hand.

Thus, in *Commissioner* v. *Forest Glen Creamery Co.* (CA7 1938) 98 F2d 968, the issue was whether a deficiency notice for a year not set forth on the face of the notice but in an addendum thereto constituted a proper notice for that year. The Court held that no particular form was required for the notice and that information contained in the addendum was sufficient to apprise the taxpayer of the year in question. A similar holding is contained in *McDonnell* v. *United States* (Ct. Cl. 1932) 59 F2d 290 where the issue was whether the Commissioner was required to advise the taxpayer in the deficiency notice that he had a right to institute proceedings before the Board of Tax Appeals.

The Commissioner also cites cases in support of his contention that the failure to explain how a given deficiency was determined has no effect on the validity of the statutory notice. In each of those cases[1] full disclosure was made to the taxpayer either at or before trial.

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[1] *Commissioner* v. *Stewart* (CA 6 1951) 186 F2d 239.
Standard Oil Co. v. *Commissioner* (1941) 43 BTA 1941.
Finder v. *Commissioner* (1961) 37 TC 411.
Troiano v. *Commissioner* (1964) 23 TCM 1418.

Nowhere are there found factors such as are present in this case, namely the unexplained disallowance of a portion of taxpayer's cost of goods sold coupled with the failure of the Commissioner to disclose before or at trial exactly what had been disallowed or to produce any evidence at trial relative to his determination.

The decision of the Court of Appeals in this case has turned the burden of proof rule, meant to be a shield for the Tax Court[2] into a powerful sword in the hands of the Commissioner. As a result of this decision the Commissioner's determinations have been placed in an almost impregnable fortress, unassailable by a mere preponderance of evidence in favor of the taxpayer. The opportunity to show the Commissioner's determination arbitrary has practically disappeared and the taxpayer must now sustain the validity of his position beyond all reasonable doubt.

The present state of the law in this area can only be clarified under the guiding hand of the Supreme Court so "that traditional forms of fair procedure not be restricted by implication or without the most explicit action by the Nation's lawmakers, even in areas where it is possible that the Constitution presents no inhibition." *Green* v. *McElroy*, 360 US 474, 508.

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[2] "The burden of proof rule is a necessary rule if the Tax Court is to dispose of the large number of cases which are inadequately presented: the Tax Court cannot be expected in view of its arduous duties, affirmatively to seek out evidence and prove taxpayer's cases for them." Mertens, *Law Of Federal Income Taxation*, Volume 9, Sections 50, 60.

In granting the application this tribunal puts the Commissioner in the enviable position of being fair with taxpayers without costing the government any money.

If there is validity in their disallowances as clearly delineated in notices, the Commissioner will prevail.

If there is no validity in disallowances the basis of which is not identifiable he should not exact the tax dollar unfairly.

Conclusion

For the reasons stated herein, the Petitioners earnestly pray that a writ of certiorari issue from this Court to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

Respectfully submitted,

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